More Efficient Event Studies
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We need more efficient event studies

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- Yet the event study methodology is a sort of fossilized technology. Modern event studies are not radically different from the methodology of B&B or FFJR half a century ago.
- If anything, there is some regress: $\beta = 1$ is a popular approximation.

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Priced Factors versus Risk Factors

CAPM and APT (including Fama French) are pricing models. They are interested in priced factors: factor betas must impact expected returns for the factor to be relevant.

But for use in an event study, a factor does not have to be priced: it simply needs to be a good predictor of the stock return. For example, suppose that the security market line is flat (or even negative) so that the CAPM is useless as a pricing model. Suppose also that the $R^2$ in a regression of stock returns on the market index is 0.55. The market model is a good tool for an event study.

• The market model does not swim or sink with the CAPM! Similarly, industry factors are valid in an event study (if the event is not industry wide).
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Factors versus Characteristics

A pricing model cannot use characteristics for arbitrage reasons:

• Small firms cannot have higher returns than large firms because a conglomerate could buy a hundred small firms cheap, become big and then have the lower cost of capital of a big firm.

• Firms that have a large beta on the size factor can have higher return because then the conglomerate would continue to have the same size beta as its hundred divisions by linearity of the beta.

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Minor point (typo?): the optimal Counter Factual does not require $i$; $\text{CF}! 1$. It requires $R^2 i; \text{CF}! 1$. 
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What is the danger?

The universe of affected firms is not always very clearly defined.

• Suppose 100 firms were clearly affected by the event and are considered in the study.
• Suppose another 20 firms were also affected to a lower extent by the event and were excluded because they were difficult to identify or because the effect on them was thought to be weak.

In this case, the Counter Factual includes 20 (weakly) event affected firms as well.
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